

CASE STUDY: SUSTAINABLE ENERGY FUND

1. THE POLICY

In 1999, the Pennsylvania Utilities Commission (PUC) created the Sustainable Energy Fund (SEF), a private, nonprofit, financial organization. This fund awarded grants and offered low-interest debt financing to energy efficiency and renewable energy related projects. This fund was generated through a society benefit fee of several cents added to ratepayers' utility bills. From 1999-2006, this fund distributed approximately \$1.5MM - \$4MM annually to over 70 projects.

In 2006, the PUC terminated the society benefit charge, and the SEF was left to work with the remaining money in the fund (approximately \$13MM), which was put into an endowment. The SEF maintained the same mandate of promoting energy efficiency and renewable energy generation; though it has a narrower market focus, primarily LEED® buildings and green building technologies. The product that SEF offers is considered gap financing, or rather a low-interest loan for energy-related projects to established commercial, industrial, municipal, and nonprofit entities in eastern and central Pennsylvania. The minimum loan amount is \$10,000; the maximum loan amount is \$1,000,000. SEF debt financing products typically have loan rates that are competitive with commercial banks and flexible loan collateral requirements.

SEF general project types are:

- Energy Efficiency/Energy Conservation Projects – that save electricity or other energy, particularly projects with a LEED® or green building technology component.
- Renewable Energy projects which draw power from naturally replenished sources. These may include solar power, wind power, geothermal power, or power generated from biomass sources.
- Clean Energy Projects that develop clean energy technology and processes that have minimal impacts on the environment, such as distributed generation projects.

As long as the project: (a) reduces energy consumption; (b) replaces a fossil fuel with a clean (or cleaner) energy source; or (c) produces clean energy (e.g. from renewable sources); then SEF will consider financing the project. SEF will also consider funding or co-funding the energy-portion of a new building construction or a building remodeling project, particularly those projects seeking LEED® certification.

2. ENERGY EFFICIENCY POTENTIAL

2.1. Program Uptake

Each year, SEF aims to originate between \$1MM and \$4MM of low-interest loans to 2 – 4 projects. One of its fundamental criteria is that the loan financing enable the energy efficiency/onsite renewable energy generation component to occur. Projects that are already sufficiently financed to incorporate green building technologies are given lower priority than those that would have to remove energy efficiency components without SEF funding. This “but-for financing” approach typically places SEF as the final piece of the financial package, and ensures that SEF funding is the direct cause of energy efficiency improvements in the buildings that it finances. This criteria has limited the number of projects interested in SEF funding, though there is not ample data to support the claim that the criteria is prohibitively strict.

2.2. Energy Savings Potential

The SEF does not have any base threshold of building performance in order to qualify for their loans. Each project is reviewed on a case-by-case basis, and qualifies if it meets the basic criteria of promoting energy efficiency or onsite renewable energy generation. SEF does require that the energy savings or energy production be documented as a condition of the loan. Nonetheless, the energy savings potential of this fund is low due to the narrowness of its impact and the highly variable standard of energy performance to which SEF holds its projects.

3. COST OF IMPLEMENTATION

3.1. Program Cost to the City

In its current form, SEF has no program cost born by the City. However, SEF has somewhat unique roots as an NGO. Originally, the fund was generated through the society benefit charge, a small surcharge on utility bills. Once this funding was cut, the SEF created an endowment and now deploys its capital through low-interest loans.

The administrative cost is \$800k annually (which includes \$100k of operating expenses and \$700k of staff salaries) and is funded, in part, through the interest payments on outstanding loans. As repayments will vary from year to year, the SEF must occasionally draw money from the endowment to pay expenses.

3.2. Cost to the Developer

Unlike a traditional commercial bank, SEF can be quite creative in structuring loan financing solutions to meet the unique requirements of each project. For example:

- SEF will finance 100% of the green building element of the project, and no out-of-pocket payments are required from the developer during the construction phase of the project.
- No loan payment is required until several months after the project is completed. By that time the energy savings from the project show up in developer's utility bills, freeing-up cash from the developer's operating budget to use for the loan payments.
- Loan payments are customized for each project to be less than the monthly energy savings, thus there is no increase to the existing operating budget, and in many cases, a net positive cash flow.
- SEF can structure the deal to fit a developer's current and future cash flow needs – including extended no-payment periods, interest-only payments for a year or more, short-term bridge loans, etc.
- Unlike many commercial banks, there never is a prepayment penalty with any SEF loans. Banks generally will require a prepayment penalty on fixed-rate loans to generate income in the event of loan prepayment. By contrast, SEF wants to help implement energy projects quickly.
- SEF will accept a higher risk position on collateral than most banks.
- For large projects, many banks do not want to finance the last 10-20% of a project. By contrast, SEF can provide that final gap financing piece to make the project happen.

Aside from the financial benefits of the highly tailored loan underwriting and structuring program, the actual cost of application is minimal, confirmed by Shazaam Realty. The application process generally requires information that any typical developer would already have at hand to apply for debt financing.

4. ADMINISTRATIVE FEASIBILITY

4.1. Administering Agency

The Sustainable Energy Fund is comprised of seven fulltime employees that fulfill marketing, administrative, and loan underwriting roles. The organization has ties with the Pennsylvania Utilities Commission and PPL Public Utilities, but essentially runs the fund independent of other organizations.

4.2. Ease of Initiation

The SEF developed a good track record of working with developers from 1999-2006 when it was still funded through the society benefit charge. Thus, it had a substantial amount of momentum when it entered into its current working model as an endowment making primarily low-interest loans. The fund was capitalized with the remainder of the fund, and SEF was tasked with developing a strategy for deploying its capital. One key obstacle was that, in the new model, SEF had very limited grants offerings, historically a very attractive financing option for developers. Additionally, the loans were at times with a higher interest rate than market rate. This resulted in

waning developer interest in partnering with SEF. To remedy the situation, SEF is currently in the process of unveiling a new regime of programs and financial products that are designed to fill an identified market need – gap financing for the energy efficiency components of LEED® buildings.

4.3. Funding Requirements

The endowment currently stands at just under \$16MM, which is managed as a revolving commercial loan fund, distributing approximately \$1MM to \$4MM annually. The amount distributed in low-interest loans is entirely dependent on the quality of applying projects. The target for 2008 is \$3.5MM of deployed capital. The interest payments are generally used to pay the overhead of the office and staff, though they can dip into the endowment principal if need be.

4.4. Educational Outreach Requirements

Since SEF took its current form, it has had difficulty in attracting the level of interest in its funds that the president and staff would like. Part of its struggle can be attributed to a widespread downturn in real estate development in Pennsylvania. However, according to developers, the primary obstacle for the SEF concerns marketing efforts and product offerings. Though marketing is a significant budget item for SEF (\$100k annually), it has been challenging to devise strategies that market effectively to a diffuse developer community. Consequently, it has been necessary for SEF to partner with other organizations such as trade groups (e.g. installers) or real estate services organizations to spread the message of their fund. This approach, however, has not borne impressive results thus far in terms of generating developer interest in the SEF. In terms of product offerings, the commercial loans that SEF currently offers are unique to real estate financing in terms of their underwriting and loan structure. Further educational campaigns and materials could help attract more developer interest and assuage their concerns over pursuing alternative financing options.

5. STAKEHOLDER IMPACTS

5.1. Acceptability to the Developer

Developers who have received SEF funding are quite enthusiastic about the program. This group of developers is quite small, however, due to relatively short time of the program's existence and the difficulties that SEF has experienced in educating the developer community concerning its programs. According to Shazaam Realty, there are a range of benefits of accepting SEF funding, including: accessing the additional funding for energy efficiency related building components; the publicity benefits; and the easy application. In one Shazaam Realty project, 345 Market Street in Kingston, Pennsylvania, the developer claimed that having SEF funding was critical to his application for financing from national banks. Additionally, the SEF brand framed the project as one that was providing a public benefit, which generated interest and support from both private financiers and government agencies. The only drawbacks cited were related to the competitiveness of the loan interest rates, which were often higher than those offered by local banks. In the case of the aforementioned project, even with a relatively high interest rate on the loan, the returns on that investment were well worth it, in terms of access to additional financing and public interest (and for potential future projects). In the most recent product offerings, SEF has lowered the loan interest rate to prime or below prime rates.

6. REFERENCES

Jennifer Hopkins, President, Sustainable Energy Fund
 Bill Routson, Program Manager, Sustainable Energy Fund
 Dave Selingo, Developer, Shazaam Realty